

Distribution Pricing Principles and Information Disclosure Guidelines

Prepared by the Electricity Commission
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Executive summary

1. On 5 June 2009, the Electricity Commission (**Commission**) published a consultation paper (**First Consultation Paper**) proposing a model approach to an electricity distribution pricing methodology. As a starting point, the model approach used the model pricing methodology developed by the Pricing Approaches Working Group (**PAWG**). The PAWG was a consultative group, made up of industry participants, formed to develop a voluntary model approach to distribution pricing (**PAWG model approach**), prior to the establishment of the Commission, but whose work was continued by the Commission.
2. A workshop was held in June 2009 to discuss the approach set out in the First Consultation Paper.
3. On 30 September 2009, the Commission published a discussion paper (**Second Consultation Paper**), and held a workshop for interested stakeholders on 12 October 2009 (**October workshop**). Proposed pricing principles, methodological requirements and compliance reporting were discussed at the October workshop. The Second Consultation Paper:
 - (a) reconsidered the degree of prescription inherent in the model approach to a distribution pricing methodology;
 - (b) noted there was no longer widespread acceptance by distributors and retailers of the PAWG model approach. This appeared to be the result of the relatively prescriptive nature of the PAWG model approach; and
 - (c) noted there was widespread support from distributors (in particular) and retailers (to a slightly lesser extent) for the Commerce Commission's preliminary view, in the context of part 4 of the Commerce Act, that a principles-based approach to pricing methodologies was appropriate for distributors.
4. The Second Consultation Paper outlined the Commission's preliminary view that:
 - (a) a principles-based approach to a distribution pricing methodology should be adopted; and
 - (b) guidelines (or methodological requirements) should be provided to assist stakeholders with interpreting and implementing the proposed principles-based approach.
5. The Commission agreed with submitters that, where possible given the objectives of the two Commissions, the treatment of distribution pricing should be consistent between the Commerce Commission and itself. Accordingly, the Commission developed a principles-based approach and, where practicable, aligned it with the Commerce Commission's approach in respect of the Gas Authorisation for Powerco and Vector and input methodologies discussion paper.

6. On 1 December 2009, the Commission published a third consultation paper (**Third Consultation Paper**). Following consideration of the submissions received on the Third Consultation Paper, the Commission decided on the following voluntary approach to a distribution pricing methodology:
- (a) a principles-based approach to a distribution pricing methodology should be adopted (**pricing principles**);
 - (b) the Commission will publish guidelines (**information disclosure guidelines**) to assist:
 - (i) distributors to disclose information on their distribution pricing methodology; and
 - (ii) independent expert review of the distributors' compliance with the pricing principles; and
 - (c) the Commission will initiate periodic reviews by independent experts to assess the distributors' compliance with the pricing principles, using the information disclosure requirements in the Commerce Act initially, and the information disclosure guidelines for the following and subsequent years.
7. Also, following consideration of the submissions received on the Third Consultation Paper, the Commission adopted suggestions relating to:
- (a) clarifying the pricing principles;
 - (b) enhancing the information disclosure guidelines;
 - (c) the timetable for having independent experts undertake periodic reviews of the distribution pricing methodologies; and
 - (d) ensuring consistency with the policy direction set out in the Ministerial Review and the Electricity Industry Bill.
8. The Commission's final pricing principles are as follows:

| Pricing Principles | |
|---------------------------|---|
| (a) | Prices are to signal the economic costs of service provision, by: |
| (i) | being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulation; |
| (ii) | having regard, to the extent practicable, to the level of available service capacity; and |
| (iii) | signalling, to the extent practicable, the impact of additional usage on future investment costs. |

| Pricing Principles | |
|---------------------------|---|
| (b) | Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable. |
| (c) | Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of stakeholders in order to: |
| (i) | discourage uneconomic bypass; |
| (ii) | allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or non-standard arrangements for services; and |
| (iii) | where network economics warrant, and to the extent practicable, encourage investment in transmission and distribution alternatives (e.g. distributed generation or demand response) and technology innovation. |
| (d) | Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders. |
| (e) | Development of prices should have regard to the impact of transaction costs on retailers, consumers and other stakeholders and should be economically equivalent across retailers. |

9. The Commission's final information disclosure guidelines are as follows:

| Information Disclosure Guidelines | |
|--|--|
| (a) | Prices should be based on a well-defined, clearly explained and published methodology, with any material revisions to the methodology notified and clearly marked. |
| (b) | The pricing methodology disclosed should demonstrate: |
| (i) | how the methodology links to the pricing principles and any non-compliance; |
| (ii) | the rationale for consumer groupings and the method for determining the allocation of consumers to the consumer groupings; |
| (iii) | quantification of key components of costs and revenues; |
| (iv) | an explanation of the cost allocation methodology and the rationale for the allocation to each consumer grouping; |
| (v) | an explanation of the derivation of the tariffs to be charged to each consumer group and the rationale for the tariff design; and |

| Information Disclosure Guidelines | |
|--|--|
| (vi) | pricing arrangements that will be used to share the value of any deferral of investment in distribution and transmission assets, with the investors in alternatives such as distributed generation or load management, where alternatives are practicable and where network economics warrant. |
| (c) | The pricing methodology should: |
| (i) | employ industry standard terminology, where possible; and |
| (ii) | where a change to the previous pricing methodology is implemented, describe the impact on consumer classes and the transition arrangements implemented to introduce the new methodology. |

10. In summary, the timetable and process is:

- (a) the Commission publishes the pricing principles and information disclosure guidelines (February 2010);
- (b) distributors use the information disclosure guidelines to report against the pricing principles, with a review to assess alignment (March 2011);
- (c) possible decision on whether more standardisation of tariff structures is required (October 2011);
- (d) formal review against the pricing principles using the information disclosure guidelines (March 2012);
- (e) each distributor receives an independent expert's draft report on compliance of the distributor's pricing methodology against the pricing principles (July 2012);
- (f) distributors respond to the Electricity Authority on the findings of the report (September 2012);
- (g) the Electricity Authority publishes a summary of the independent reviews (November 2012); and
- (h) subsequent reviews when a distributor amends its pricing methodology.

11. In future, distributors will be required to disclose under both the information disclosure guidelines and the Commerce Commission's part 4 information disclosure requirements each year. It is expected that the information disclosure guidelines will inform the Commerce Commission's deliberations on its disclosure regime.¹ It is also expected that the information disclosed under the information disclosure guidelines will be the same as the information disclosed under part 4. Therefore, distributors will be required to prepare one set of information for the two disclosures.

¹ The Commerce Commission will be reviewing the information disclosure requirements once input methodologies are set so the Part 4 information disclosure requirements for pricing may change.

12. The reviews that will be conducted on distribution pricing methodologies will highlight the extent of the number and complexity of tariffs and may lead to guidelines for improvements, particularly in the smaller network areas. More standardisation of lines tariff structures should evolve from the reviews, which will highlight best practice and identify networks where pricing is inconsistent with the pricing principles.
13. In deciding on a principles-based approach to distribution pricing, the Commission has noted clause 45(2)(e) of the Electricity Industry Bill 2009 which requires the proposed Electricity Authority to consider requirements for distributors to use more standardised distribution line tariff structures and use-of-system rules. However, it is important to appreciate that the Commission's decision on a principles-based approach does not purport to meet the requirements in clause 45(2)(e).
14. Hopefully however the work done in deciding on a principles-based approach will assist the proposed Electricity Authority in its consideration of any further work to be done in this area.

Low level elements

15. A number of distributors and retailers suggested that some of the difficulties with the interface between them could be addressed by bilateral discussions facilitated by the Commission. These issues were characterised as "low level elements" and related to standardisation of nomenclature and information exchange between retailers and distributors. Accordingly, the Commission formed an industry group (the Distribution Pricing Administrative Issues Working Group) to discuss and make recommendations on these low level elements.
16. The Distribution Pricing Administrative Issues Working Group's recommendations will inform a number of initiatives the Commission has to increase the level of standardisation in respect of the inter-related issues of reconciliation process and use-of-system agreements. These initiatives will contribute to reductions in the transaction costs faced by retailers.

Glossary of abbreviations and terms

| | |
|---|---|
| Act | means the Electricity Act 1992 |
| Commerce Act | means the Commerce Act 1986 |
| Commission | means the Electricity Commission |
| Consumer | means any person who is supplied electricity for consumption and includes a distributor, retailer or generator where the distributor, retailer or generator is supplied with electricity for its own consumption |
| Distributed Generation Regulations | means the Electricity Governance (Connection of Distributed Generation) Regulations 2007 |
| Distributor or Electricity Distribution Business (EDB) | means any electricity industry participant who owns or operates a network (that is not an embedded network) other than Transpower |
| First Consultation Paper | means the consultation paper, <i>Distribution Pricing Methodology – consultation paper on a model approach</i> , published by the Commission on 5 June 2009 |
| ICP | means a point of connection on a local network or embedded network, having the attributes set out in rule 1 of schedule E1 of the Electricity Governance Rules 2003 |
| GPS | means the Government Policy Statement on Electricity Governance published in May 2009 |
| Load Group | means a category of consumers from which load-dependent costs (i.e. costs incurred by a distributor to provide network capacity to supply the load on its network) will be recovered |
| MUoSA | Model Use of System Agreement |
| Network | means the lines, and associated equipment, owned or operated by a distributor in a contiguous geographic area or areas |
| PAWG | means the Pricing Approaches Working Group, which was a consultative group formed by the Electricity Networks Association for the purpose of developing voluntary model approaches to distribution pricing in New Zealand |
| PAWG model approach | means the recommended model approach for distribution pricing set out in the PAWG report |

| | |
|----------------------------------|---|
| PAWG report | means the PAWG report, <i>Model Approaches to Distribution Pricing</i> dated February 2005 |
| Retailer | has the meaning set out in part A of the Rules |
| Rules | means the Electricity Governance Rules 2003 |
| Second Consultation Paper | means the paper, <i>Discussion Paper – Draft Distribution Pricing Principles and Methodological Requirements</i> , published by the Commission on 30 September 2009 |
| Third Consultation Paper | means the paper, “ <i>Distribution Pricing Principles and Information Disclosure Guidelines</i> ”, published by the Commission on 1 December 2009 |
| TPM | means the Transmission Pricing Methodology set out in schedule F5 of section IV of part F of the Rules |

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1. Introduction

1.1 Consultation undertaken on a model approach

- 1.1.1 On 5 June 2009, the Electricity Commission (**Commission**) published a consultation paper (**First Consultation Paper**) titled “Distribution Pricing Methodology, Consultation paper on a model approach”.² The First Consultation Paper proposed a model approach to an electricity distribution pricing methodology and asked interested stakeholders to comment.
- 1.1.2 As a starting point, the model approach used the model pricing methodology developed by the Pricing Approaches Working Group (**PAWG**). The PAWG was a consultative group, made up of industry participants, formed to develop a voluntary model approach to distribution pricing (**PAWG model approach**), prior to the establishment of the Commission, but whose work was continued by the Commission.
- 1.1.3 On 17 June 2009, the Commission held a workshop for interested stakeholders to discuss the First Consultation Paper and to facilitate the preparation of submissions. Submissions on the First Consultation Paper closed on 10 July 2009 and the Commission received 27 submissions.³
- 1.1.4 Following consideration of the submissions on the First Consultation Paper, the Commission reviewed the model approach and developed a revised approach. The revised approach was a lighter-handed approach, and more consistent with the Commerce Commission’s direction, which was to favour a principles-based approach.
- 1.1.5 On 30 September 2009, the Commission published a discussion paper (**Second Consultation Paper**) titled “Draft Distribution Pricing Principles and Methodological Requirements”.⁴ The Second Consultation Paper outlined the Commission’s preliminary view that:

² The First Consultation Paper can be viewed at:
<http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/pdfsconsultation/distribution-pricing-methodology.pdf>

³ The submissions received can be viewed on the Commission’s website at:
<http://www.electricitycommission.govt.nz/submissions/subtransmission/distrib-pricing>.

⁴ The Second Consultation Paper can be viewed on the Commission’s website at:
<http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/distrib-pricing/discussionpaper-Sep09.pdf>

- (a) a principles-based approach to a distribution pricing methodology should be adopted; and
- (b) guidelines (or methodological requirements) should be provided to assist stakeholders with interpreting and implementing the proposed principles-based approach.

1.1.6 On 12 October 2009, the Commission held a workshop for interested stakeholders to discuss the Second Consultation Paper and to facilitate the preparation of submissions. Submissions on the Second Consultation Paper closed on 30 October 2009 and the Commission received 18 submissions.⁵

1.1.2 On 1 December 2009, the Commission published a third consultation paper (**Third Consultation Paper**) titled “Draft Distribution Principles and Information Disclosure Guidelines”.⁶ The Third Consultation Paper further developed the principles-based approach and the proposed guidelines.

1.1.7 The Commission received 14 submissions from the following parties:⁷

Table 1: submitters on Third Consultation Paper

| Distributors | Retailers | Consumers |
|---|---|--------------------------------|
| Orion, PriceWaterhouseCoopers (representing 22 distributors), Northpower, Electricity Networks Association, WEL Networks, Vector, Unison, Powerco | Contact, Mighty River Power, Meridian, Powershop, TrustPower, | Domestic Energy Users' Network |

1.2 Principles-based model approach

1.2.1 Following consideration of the submissions on the Third Consultation Paper, the Commission decided on the following model approach to a distribution pricing methodology:

⁵ The submissions received can be viewed at: <http://www.electricitycommission.govt.nz/submissions/subtransmission/draft-pricing-principles>.

⁶ The Third Consultation Paper can be viewed at: <http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/pdfsconsultation/draft-pricing-principles-guidelines.pdf>

⁷ The submissions received can be viewed at: <http://www.electricitycommission.govt.nz/submissions/subtransmission/distpricing-infodisclosure>

- (a) a principles-based approach to a distribution pricing methodology should be adopted (**pricing principles**);
- (b) the Commission will publish guidelines (**information disclosure guidelines**) to assist distributors in respect of the disclosure of information on their distribution pricing methodology, and the review of the distributors' compliance with the pricing principles; and
- (c) the Commission will initiate periodic reviews by independent experts to assess the distributors' compliance with the pricing principles, initially using the information disclosure requirements in the Commerce Act, and then using the information disclosure guidelines in subsequent years.

2. Background

2.1 Key reasons for a model approach

2.1.1 The overarching reason for a model approach to a distribution pricing methodology is to assist distributors in structuring their distribution prices to deliver economically efficient outcomes.⁸

2.1.2 The Commission expects that the benefits of a model approach will include:

- (a) distributors charging for distribution services in a way that:
 - (i) encourages the efficient use of electricity by consumers;
 - (ii) encourages efficient investment in distribution, transmission, distributed generation (including renewable generation), and technology innovation;
 - (iii) maintains or enhances investment in energy efficiency and demand-side management;
 - (iv) signals the full costs of transporting electricity to consumers; and
- (b) retail competition is facilitated by reducing the transaction costs faced by retailers competing for consumers across multiple distribution networks.

2.1.3 In particular, a model approach to a distribution pricing methodology should benefit consumers in smaller distribution networks where retailers do not have the same economies of scale in systems and processes to accommodate varying approaches to distribution pricing.⁹

2.2 The Commission's initial view on a model approach

2.2.1 The First Consultation Paper set out a model approach to a distribution pricing methodology. In the Commission's view, the model approach furthered the Commission's principal objectives under the Electricity Act 1992 (**Act**), and gave effect to the objective in paragraph 100 of the 2009 Government Policy Statement on Electricity Governance (**GPS**):

"The Commission should develop, in consultation with interested parties, principles or model approaches to distribution pricing and monitor their uptake."

⁸ See the First Consultation Paper [at page 11].

⁹ Ibid [at paragraph 2.5.2].

2.2.2 The Commission also noted that a model approach was consistent with the PAWG model approach, which the Commission understood had received widespread acceptance from distributors and retailers at the time of its development and publication.

2.3 PAWG model approach

2.3.1 The Commission considered that a model approach based on the PAWG model approach was consistent with the objective of reducing barriers to retail competition. If distributors' pricing methodologies were developed in largely the same manner, the transaction costs faced by retailers competing across multiple networks could be lowered.

2.3.2 However, there were potential problems with the PAWG model approach as its prescriptive nature raised issues of price setting under part 4 of the Commerce Act. The Commerce Commission had noted concerns regarding overly prescriptive pricing methodologies,¹⁰ including:

- (a) the information asymmetry between distributors and the regulator in determining efficient prices (or the possibility that neither party has access to relevant information);¹¹
- (b) whether distributors have sufficient flexibility to respond to changes in market conditions and consumers' demand;¹² and
- (c) associated compliance costs.¹³

2.3.3 These issues meant that, over time, a model approach based on the PAWG model approach could have lower efficiency benefits than a less prescriptive methodology. A lighter-handed approach is also more appropriate, where the benefits of enhanced retail competition from standardised distribution pricing are not demonstrated to be greater than the costs.

¹⁰ See the Commerce Commission's *Input Methodologies Discussion Paper*, 19 June 2009 at paragraph 9.52 [The Commerce Commission's views would exclude any benefits associated with facilitating retail competition.] The *Input Methodologies Discussion Paper* is available at: <http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/IM-final.pdf>

¹¹ Ibid at paragraphs 9.21 and 9.52. [In the First Consultation Paper the Commission sought to address this issue by providing for distributors to vary from the model approach to a distribution pricing methodology if they had good reason.

¹² Ibid at paragraph 9.47.

¹³ See Commerce Commission, *Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Draft Decisions Paper*, 4 October 2007, p 302; and Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009, paragraph 9.22.

2.4 The Commission's revised view on a model approach

2.4.1 The submissions received on the First Consultation Paper showed that there was widespread support (from distributors (in particular) and retailers (to a slightly lesser extent)) for the Commerce Commission's view¹⁴ that a principles-based approach to pricing methodologies for distributors is more appropriate.

2.4.2 Noting the lack of support for a more prescriptive model approach, and the relatively broad support for a principles-based approach, the Commission revisited the intent behind a model approach to a distribution pricing methodology.

2.4.3 The Commission agreed with submitters that, where possible given the objectives of the two Commissions, the treatment of distribution pricing should be consistent between the Commerce Commission and itself. Accordingly, the Commission developed a principles-based approach to a distribution pricing methodology and, where practicable, aligned it with the Commerce Commission's approach in respect of the Gas Authorisation for Powerco and Vector.¹⁵ In doing so, the Commission took into consideration the Commerce Commission's views on pricing methodologies, as set out in its Input Methodologies Discussion Paper.¹⁶

2.4.4 The Commission notes that the Commerce Commission's focus on distribution pricing is in the context of part 4 of the Commerce Act, and is not related to enhancing retail competition. In that context, the Commerce Commission's view on distribution pricing is as follows:¹⁷

- a principles based approach to pricing methodologies is appropriate for [distributors that it regulates]; and
- the principles should be based upon the output of the Electricity Commission's Distribution Pricing Project, to the extent that:
 - such principles, guidelines and/or model distribution pricing methodology or approaches are consistent with the relevant provisions of the Commerce Act; and

¹⁴ In the context of part 4 of the Commerce Act.

¹⁵ See Commerce Commission, *Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Decision Paper*, 30 October 2008, available at: [http://www.comcom.govt.nz/IndustryRegulation/Gas/CommissionReportsandDocuments/ContentFiles/Documents/\[PUBLIC\]%20Gas%20Authorisation%20-%20Decisions%20Paper%20-%2031%20October%202008.pdf](http://www.comcom.govt.nz/IndustryRegulation/Gas/CommissionReportsandDocuments/ContentFiles/Documents/[PUBLIC]%20Gas%20Authorisation%20-%20Decisions%20Paper%20-%2031%20October%202008.pdf)

¹⁶ See the Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009 at chapter 11.9, paragraphs 11.107-11.129.

¹⁷ See Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009, paragraph 11.121.

- are available in sufficient time for the [Commerce] Commission to take those decisions into account within the statutory timeframes for determining input methodologies.

2.4.5 Noting that the Commission has a broader mandate in respect of distribution pricing, the Commission reformulated the Commerce Commission's principles set out in the Gas Authorisation into pricing principles, and further incorporated:

- (a) its principal objectives in the Act to ensure electricity is delivered to all classes of consumers in a fair, reliable and environmentally sustainable manner and to promote and facilitate the efficient use of electricity;¹⁸
- (b) the relevant objectives in the transmission pricing methodology (**TPM**),¹⁹ and the Electricity Governance (Connection of Distributed Generation) Regulations 2007 (**Distributed Generation Regulations**); and
- (c) feedback received on the First Consultation Paper and at the 17 June 2009 workshop.

2.4.6 The Commission considered that an intermediate level of detail in a model approach to a distribution pricing methodology was appropriate for the following reasons:

- (a) the economic efficiency benefits of a pricing principles approach are likely to be greater than under a more prescriptive methodology. Indeed, the benefits of a more prescriptive approach may be close to zero where there is no ability to prevent retailers from rebundling distribution price structures in a manner that weakens their economic signalling effect;
- (b) it aligned with the Commerce Commission's approach for the gas sector,²⁰ and
- (c) it could be adapted to encompass the Commission's broader mandate in respect of distribution pricing.

2.4.7 In the Second Consultation Paper, the Commission outlined its preliminary view that a principles-based approach to a distribution pricing methodology should be adopted, coupled with guidelines (methodological requirements) to assist stakeholders with interpreting and implementing the pricing principles. As with the First Consultation Paper, this paper received substantial feedback from submitters, at the workshop held in October 2009 and in written submissions.

¹⁸ See ss172N(1)(a) and (b) of the Electricity Act 1992.

¹⁹ In schedule F5, section IV, part F of the Rules.

²⁰ See the Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009, under the section, "Pricing Methodologies – Approach and level of detail in pricing principles" p449.

2.4.8 Most submitters on the Second Consultation Paper expressed concern about the methodological requirements. The Commission agreed that prescriptive pricing methodologies were not required and, to clarify this, proposed to establish information disclosure guidelines in place of the methodological requirements, as well as introducing a monitoring and reporting regime.

2.4.9 Therefore, in the Third Consultation Paper, the Commission proposed that:

- (a) a principles-based approach to a distribution pricing methodology should be adopted;
- (b) the Commission would publish information disclosure guidelines to assist distributors in respect of the disclosure of information on their distribution pricing methodology, and the review of the distributors' compliance with the pricing principles; and
- (c) the Commission would initiate periodic reviews by independent experts to assess the distributors' compliance with the pricing principles, initially using the information disclosure requirements in the Commerce Act initially, and then the information disclosure guidelines in subsequent years.

3. Submissions on Third Consultation Paper

3.1.1 The Commission received 15 submissions²¹ on the Third Consultation Paper, including one submission from PriceWaterhouseCoopers (**PWC**) on behalf of 22 distributors. The other submitters were:

- (a) the Domestic Energy Users' Network (**DEUN**) on behalf of domestic consumers (1);
- (b) retailers (5);²²
- (c) distributors (7);²³ and
- (d) the Electricity Networks Association (**ENA**) (1).

3.1.2 The consolidated responses to the questions in the Third Consultation Paper and the Commission's comments on the responses are contained in appendix one of this paper.

3.2 Summary of submissions on pricing principles and the Commission's comments

3.2.1 The Third Consultation Paper asked the question: "Do you agree with the wording of these proposed principles?"

3.2.2 In general terms, the retailers were concerned that the principles were not specific enough and more prescriptive provisions should be included. For example, Mighty River Power (**MRP**) commented:

"Mighty River Power is generally supportive of a principles-based approach. We are supportive of providing EDBs with discretion over such matters as cost allocation (within bounds such as incremental and stand-alone costs). Where we believe greater prescription than the Electricity Commission is proposing is needed is on "low level elements". Matters such as customer definition, number of tariff categories and complexity of tariff structures can have a substantial impact on transaction costs and retail competition, particularly in small EDB network areas."

3.2.3 The Commission accepts that the low level elements referred to by MRP may increase transaction costs and reduce retail competition. However, greater prescription may not necessarily result in higher net benefits. This is because

²¹ The submissions are available at: <http://www.electricitycommission.govt.nz/submissions/transsubs>

²² Contact Energy, Meridian Energy, Powershop, Mighty River Power and TrustPower.

²³ Wellington Electricity Lines Limited (WELL), Northpower, Orion, Vector, Powerco, Unison and WEL Networks.

prescribing a single approach to a number of tariffs of varying complexity for all 29 distributors will incur significant costs.

3.2.4 However, the Commission considered that the suggestion of a bilateral approach, facilitated by the Commission, to address administrative issues (i.e. low level elements) had merit. Accordingly, the Commission formed the Distribution Pricing Administrative Issues Working Group (made up of industry representatives, an independent retailer and a consumer representative) to discuss and make recommendations regarding administrative issues. These issues included:

- (a) wash-ups;
- (b) unnecessary complexity;
- (c) unaccounted-for electricity; and
- (d) common terminology.

3.2.5 The Distribution Pricing Administrative Issues Working Group's recommendations will inform a number of initiatives the Commission has to increase the level of standardisation in respect of the inter-related issues of reconciliation process and use-of-system agreements. These initiatives will contribute to reductions in the transaction costs faced by retailers.

3.2.6 Contact Energy considered that the pricing principles required greater prescription around pricing structures and transaction costs:

"Prices should be predictable and provide certainty for retailers to enable pass through without the need for repackaging or retrospective billing adjustments."

3.2.7 However, rather than making the pricing principles more prescriptive, the Commission considers that it should develop guidelines that illustrate the outcomes which are consistent with the principles.

Principle (a)

3.2.8 TrustPower commented that:

"Principle (a) (i) should be amended to allow subsidies where it is not practicable to accurately reflect the true cost of additional usage on future investment costs. This would be achieved by simply adding the words "or an inability to practically apply the cost of additional usage on future investment costs as detailed in (iii)" at the end of the paragraph."

3.2.9 The Commission considers that the range between incremental costs and standalone costs allows for pragmatism in the allocation of costs.

Principle (b)

- 3.2.10 DEUN disagreed with what it described as, “the principle of charging the most captive consumers the highest prices.”
- 3.2.11 However, this is not the intention of principle (b). The intention is that the required revenue that is not able to be efficiently allocated to a specific user should be recovered in the least distortionary manner. This principle is analogous to the transmission pricing principle that requires that “sunk costs should be allocated in a way that minimises distortions to production/consumption and investment decisions made by grid users.”
- 3.2.12 The Commission considers that this is the most efficient way of pricing.

Principle (c)

- 3.2.13 DEUN stated that it disagreed with, “the idea of encouraging investment in transmission or distribution alternatives, including distributed generation and demand response, qualified by “where network economics warrant” and suggested that “alternatives should be encouraged wherever the overall economics warrant, not where network economics warrant.”
- 3.2.14 The Commission does not agree with DEUN’s suggestion as it extends beyond the scope of distribution pricing to assess “overall economics”.
- 3.2.15 Wellington Electricity Lines Limited (**WELL**), Vector and Powerco suggested that principle (c)(iii) should be reworded to state:
- “where network economics warrant and to the extent practicable, encourage investment in ~~transmission and~~ distribution alternatives (e.g. distributed generation or demand response) and technology innovation.”
- 3.2.16 PWC suggested that c(iii) should be deleted in its entirety as:
- “These concepts are already covered by other forms of regulation. The CC is developing explicit regulatory mechanisms to address energy efficiency, to ensure EDBs are not disincentivised from investing in energy efficiency initiatives. Distributed generation is adequately covered by the Distributed Generation Regulations and inclusion of this requirement in a pricing methodology principle is confusing, excessive and creates potential inconsistencies in the regulations applying to EDBs.”
- “Distribution alternatives and technology innovation are not objectives which are readily achieved through pricing methodologies, but they are objectives which can be disincentivised by overly prescriptive regulation.”

- 3.2.17 The Commission agrees that the addition of the phrase “**and to the extent practicable**” would be consistent with the practicality provision in the other principles and considers that distribution pricing can and should influence end users to reduce the need for investment in transmission, where practicable. Distributors should, at least, pass through the pricing signals contained in the transmission pricing methodology.
- 3.2.18 The Commission considers that the deletion of principle (c)(iii) would not be consistent with the objectives of the Commission. The fact that the concepts of “demand response” and “distributed generation” are contained in other regulation does not justify removing them from pricing principles as the concepts are presented as examples, not as alternative regulation. The Commission also considers pricing to be a major factor in encouraging distribution alternatives and technology innovation. For example, the impact of load control tariffs has led to consumers investing in technology that will reduce their costs and produce a substantial reduction in distribution network investment through peak demand reduction, and efficient use of the network assets due to load factor improvement.

Principle (d)

- 3.2.19 PWC suggested deleting “transparent” from principle (d) as the disclosures themselves will achieve transparency.
- 3.2.20 The Commission disagrees with PWC’s suggestion because transparency is essential. It should be part of the principles for a distribution pricing methodology and the principles should be complete in themselves.
- 3.2.21 WELL suggested that “promote” be replaced with “have regard for” as stability and certainty, while desirable, are not always possible and should not be promoted at the cost of innovation and would send incorrect market signals to consumers.
- 3.2.22 The Commission disagrees with WELL’s suggestion. The Commission considers that prices should promote stability and certainty, not just have regard for them.

Principle (e)

- 3.2.23 DEUN objected to the introduction of “stakeholder” as a generic term to encompass all industry participants as it interpreted the term to exclude consumers and, in particular, domestic consumers. TrustPower also commented on the fact that principle (e) did not refer to consumers.
- 3.2.24 This was not the intention and, to clarify that consumers are stakeholders and are affected by distribution pricing, the wording of principle (e) will be amended to add “**consumers and other stakeholders**”.

3.2.25 Powerco submitted that it was uncertain how principle (e) will be interpreted and it would be very difficult for Powerco to calculate the impact of its pricing on retailers.

3.2.26 Vector submitted that:

“In our view, the impact of transaction costs on retail competition that arise through distribution pricing has been somewhat overstated ...

...

Ultimately, we accept the inclusion of the ‘impact of transaction costs on retailers’ in this pricing principle but only as a consideration amongst other pricing principles.”

3.2.27 The Commission accepts that there may be a need for guidelines to be produced on the range of impacts that distributors should consider in developing their pricing. However, the guidelines may not be necessary if distributors are able to make balanced decisions when weighing the expected cost to retailers from any change against the expected benefits to their own consumers.

3.3 Final pricing principles

3.3.1 The Commission has noted the feedback on the Third Consultation Paper and the suggestions as to how the pricing principles may be clarified.

3.3.2 The table below sets out the Commission’s final pricing principles. The underlined text shows changes to the draft pricing principles proposed in the Third Consultation Paper.

| Principle | Comments on changes |
|---|---------------------|
| <p>(a) Prices are to signal the economic costs of service provision, by:</p> <p>(i) being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulations and/or the Government Policy Statement;</p> <p>(ii) having regard, to the extent practicable, to the level of available service capacity; and</p> | |

| Principle | Comments on changes |
|--|--|
| (iii) signalling, to the extent practicable, the impact of additional usage on future investment costs. | |
| (b) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable. | |
| (c) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of stakeholders in order to: <ul style="list-style-type: none"> <li data-bbox="197 1059 703 1093">(i) discourage uneconomic bypass; <li data-bbox="197 1115 719 1346">(ii) allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or non-standard arrangements for services; and <li data-bbox="197 1368 715 1682">(iii) where network economics warrant, <u>and to the extent practicable</u>, encourage investment in transmission distribution alternatives (e.g. distributed generation or demand response) and technology innovation. | The amendment to c (iii), suggested by a number of submitters, makes it consistent with other principles where practicality is an important consideration. |
| (d) Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders. | |
| (e) Development of prices should | One submission pointed out that |

| Principle | Comments on changes |
|---|--|
| <p>have regard to the impact of transaction costs on retailers, <u>consumers and other stakeholders</u> and should be economically equivalent across retailers.</p> | <p>distributors should also have regard to the impact of transaction costs on consumers. This amendment retains the focus on retailers and reinforces the fact that consumers are also stakeholders.</p> |

3.3.3 Where conflicts arise in applying the pricing principles, they should be resolved with the objective of best satisfying the Commission’s principal objectives under section 172N of the Act.

3.4 Summary of submissions on information disclosure guidelines and the Commission’s comments

3.4.1 The Third Consultation Paper included two questions on the proposed information disclosure guidelines:

- (a) “Do you support the concept of information disclosure guidelines rather than the more prescriptive methodological requirements?”
- (b) “Do you agree with the wording of these proposed information guidelines?”

3.4.2 The consolidated responses to these questions and the Commission’s comments on the responses are contained in appendix one of this paper.

3.4.3 There was general support for the concept of information disclosure guidelines rather than methodological requirements, DEUN and Meridian being notable exceptions.

3.4.4 DEUN stated:

“DUEN rejects the document’s proposed reliance on guidelines instead of prescribed methodologies for information disclosure. Poorly defined information disclosure led to extensive manipulation during the 1990s of lines company accounts, enabling massive transfers of wealth from consumers to lines companies.”

3.4.5 Meridian stated:

“Meridian does not support guidelines for distribution pricing over more prescriptive methodological requirements. Guidelines for distribution companies have not yet had any discernable effect, and there is no reason to expect they would have an effect now.”

- 3.4.6 The Commission considers that guidelines are consistent with a persuasive approach in the first instance. If, at any time, the Commission considered that a distributor had not provided sufficient information or was materially non-compliant with the principles, it would seek to persuade the distributor to comply. If there was no improvement, the Commission would consider targeted regulation.
- 3.4.7 The Commission notes that the Ministerial Review of Electricity Market Performance and clause 45(2)(e) of the Electricity Industry Bill 2009 indicate that greater prescription in respect of distribution pricing is likely unless it can be demonstrated that such prescription is unnecessary. The Commission expects that distributors will also note this policy direction.
- 3.4.8 In addition to the general comments discussed above, there were a number of suggested changes to the wording of the proposed information disclosure guidelines.

Guideline (a)

- 3.4.9 Both Orion and Unison suggested that: guideline (a) could be more clearly expressed as:
- "Prices should be based on a well defined, clearly explained methodology, with any *material* revisions *to the methodology* notified and clearly marked."
- 3.4.10 PWC submitted that:
- "[Guideline (a)] is superfluous and we do not support its inclusion. This is the disclosure requirement, i.e.: to publish a methodology and any revisions to it. It should not form part of the guidelines."
- 3.4.11 The Commission considers that guideline (a) succinctly states the purpose of the guidelines, and summarises what is required.

Guideline (b)

- 3.4.12 PWC made a number of suggestions for changes to guideline (b) including:
- (a) amending the introduction to "The pricing methodology disclosed should **demonstrate**";
 - (b) removing reference to non-compliance and to distributors assessing their compliance in (b) (ii);
 - (c) removing reference to quantification of "key components of revenue" from (b) (iii);

- (d) adding “**An explanation of the derivation of the tariffs to be charged to each consumer group and the rationale for the tariff design**”, as a new (b) (v); and,
- (e) removing the existing guideline (b) (v) as:

... , the sharing of any investment deferral benefits arising from distributed generation typically forms part of a commercial contract negotiated between the distributor and generator. It is not appropriate for the details of such contracts to be publicly disclosed.”

3.4.13 The Commission agrees that the introduction should be amended and the new guideline added. However, the Commission does not consider the suggested deletions are appropriate for the following reasons:

- (a) the Commission considers that a distributor’s view on its own performance against the pricing principles is useful information;
- (b) the key components of revenue are useful in understanding a pricing methodology and the guideline is related to the current information disclosure requirements under the Commerce Act which require that distributors:

“Describe the method by which the disclosing entity allocated the components of the revenue required to cover the costs of its line business activities amongst consumer groups.”

- (c) the Commission does not agree that guideline (b) (v) requires distributors to disclose commercial details, only the method used to share the value of any deferral with investors in distribution alternatives should be disclosed.

3.4.14 Vector proposed two amendments to guideline (b):

- (a) amend guideline (b) (iv) by deleting “and the method for determining the allocation of consumers to each consumer grouping” as it is likely to be covered off in the explanation of the cost-allocation methodology; and
- (b) amend guideline (b) (v) by including “**where network economics warrant**” to align with the suggested change to the corresponding pricing principle.

3.4.15 The Commission does not agree with Vector’s proposed deletion as the allocation of consumers to consumer groups is a crucial step in a pricing methodology. However, the Commission agrees that “where network economics warrant” should be added.

Guideline (c)

3.4.16 Orion suggested that guideline (c) (i) be amended and expressed as:

"employ industry standard **terminology** ~~tariff formats and nomenclature~~, where possible".

3.4.17 PWC suggested deleting guideline (c) (i) and amending guideline (c) (ii) to:

"where a change to the ~~existing previous~~ pricing methodology is ~~proposed~~ implemented, describe the ~~details of~~ impact on consumer classes and the transition arrangements ~~proposed~~ implemented to ~~mitigate the redistribution of costs and 'rate shock'~~ introduce the new methodology".

3.4.18 The Commission considers that guideline (c) (i) is necessary but agrees with Orion's suggestion. The Commission is seeking that common terminology is used where possible to reduce transaction costs.

3.4.19 The Commission agrees with PWC's proposed amendment to guideline (c) (ii) as the information disclosures will be based on historical information.

4. Final information disclosure guidelines

4.1.1 The Commission has noted the feedback on the Third Consultation Paper and the suggestions as to how the information disclosure guidelines may be clarified.

4.1.2 The table below sets out the Commission's final information disclosure guidelines. The underlined and struck through text shows changes to the draft information disclosure guidelines in the Third Consultation Paper.

| Information Disclosure Guidelines | |
|--|--|
| (a) | Prices should be based on a well-defined, clearly explained and published methodology, with any <u>material</u> revisions <u>to the methodology</u> notified and clearly marked. |
| (b) | The pricing methodology disclosed should include sufficient information on the following for an independent expert to assess compliance with the pricing principles including <u>demonstrate</u> : |
| (i) | how the methodology links to the pricing principles and any non-compliance; |
| (ii) | the rationale for consumer groupings and the method for determining the allocation of consumers to the consumer groupings; |
| (iii) | quantification of key components of costs and revenues; |
| (iv) | an explanation of the cost allocation methodology and the rationale for the allocation to each consumer grouping; |
| (v) | <u>an explanation of the derivation of the tariffs to be charged to each consumer group and the rationale for the tariff design</u> ; and |
| (vi) | pricing arrangements that will be used to share the value of any deferral of investment in distribution and transmission assets with the investors in alternatives such as distributed generation or load management, where <u>alternatives are practicable and where network economics warrant</u> . |
| (c) | The pricing methodology should: |
| (i) | employ industry standard <u>terminology</u> tariff formats and nomenclature , where possible; and |
| (ii) | where a change to the existing <u>previous</u> pricing methodology is proposed <u>implemented</u> , describe the details of impact on consumer classes and the transition arrangements proposed <u>implemented to mitigate the redistribution of costs and 'rate shock'</u> introduce the new methodology. |

5. Pricing methodology review

5.1.1 In the Third Consultation Paper, the Commission outlined a proposed process and timetable for reporting in response to suggestions made in submissions on the Second Consultation Paper. Some distributors suggested that the Commission should adopt a compliance review process similar to the process used by the Commerce Commission in assessing the Asset Management Plans (**AMP**) produced annually by distributors.

5.2 Summary of submissions on pricing methodology review and the Commission's comments

5.2.1 The Third Consultation Paper asked "Do you agree with the proposed process and timetable for reporting?"

5.2.2 The consolidated responses to this question and the Commission's comments on the responses are contained in appendix one of this paper.

5.2.3 Distributors were concerned about the initial review of the pricing methodologies and the timing of the first formal review of pricing methodologies against the pricing principles. For example, PWC submitted:

"The proposed compliance process is unworkable because it will not be possible for EDBs to disclose pricing methodologies consistent with the new pricing principles by 1 April 2010. If this project is to add any real value to the electricity market, distributors must have time to consider the new principles, review their existing pricing methodologies, make changes to their existing pricing methodologies to better reflect the new principles if necessary, consult with consumers and other stakeholders, develop a transition plan, and draft and publish a new pricing methodology. This is not something that can be, nor should be, achieved by the beginning of the next pricing period on 1 April 2010.

The principles will not be published at the time EDBs are required to notify their prices for the coming year to retailers. EDBs are already well advanced in developing their prices for the pricing year commencing on 1 April 2010. It is not possible to retrospectively impose new principles into this process and accordingly the first pricing methodology disclosures consistent with the new principles must be, at the earliest, for the pricing period commencing 1 April 2011. This timetable also allows for the consultations on the Commerce Act Part 4 Input Methodologies and the Electricity Industry Bill to have progressed.

Pricing methodology disclosures for the 1 April 2010 pricing period should continue to be disclosed according to the provisions of Requirement 23 of the IDRs. The preparation of these disclosures is already well advanced as EDBs are close to finalising their prices for the forthcoming period”.

- 5.2.4 The Commission acknowledges that the Third Consultation Paper should have discussed what was intended in respect of the initial review of the pricing methodologies and the timing of the first formal review more clearly.
- 5.2.5 The Commission intended that the initial review would obtain an overall picture of existing distribution pricing methodologies as disclosed under the provisions of requirement 23 of the Information Disclosure Requirements. This was to appreciate how the existing methodologies met the new principles, before preparing for the first formal review.
- 5.2.6 Accordingly, the process has been revised and **it will not be necessary for distributors to report against the new principles in 2010.**
- 5.2.7 The first formal pricing period for which the distributors will have the opportunity to adopt and implement the new principles will be the period commencing 1 April 2011. However, distributors have the option of introducing a new pricing methodology at any time, subject to notifications contained in the use of system agreements.
- 5.2.8 The pricing principles will be available from 1 March 2010 and any pricing methodology developed subject to that date should be in accordance with the principles. It is the Commission’s expectation that distributors will implement any necessary changes to their pricing methodologies for the 2011-2012 pricing year.
- 5.3 Proposed process and timetable for reporting
- 5.3.1 The Commission has noted the feedback on the Third Consultation Paper and suggestions for clarifying the process and timetable.
- 5.3.2 The Commission decided that an independent review should be conducted periodically to assess the compliance of each distribution pricing methodology with the pricing principles. Each distributor will have an opportunity to comment on the review of its own distribution pricing methodology. A summary of the reviews will be published to provide an indication of compliance trends, problem areas, examples of best practice, and advice on improvements to the information disclosure guidelines.
- 5.3.3 The development of pricing methodologies, or changes to existing methodologies, consistent with the pricing principles, should begin to be developed from March 2010. Those methodologies should be notified to retailers by December 2010 for implementation in April 2011.

- 5.3.4 If published in accordance with the information disclosure guidelines, the notifications will provide the proposed Electricity Authority and the Government with a clear picture of distributors' intentions.
- 5.3.5 The proposed Electricity Authority should be in a position to review the notified pricing methodologies against the pricing principles from March 2011, so that by October 2011 (i.e. one year after the establishment of the proposed Electricity Authority) the Government should be able to decide if more standardisation of tariff structures is required to reduce barriers to retail competition.
- 5.3.6 It will be March 2012 (which should confirm the forward looking disclosure made in March 2011) before distributors will disclose their previously notified pricing methodologies and report against the pricing principles using the disclosure guidelines.
- 5.3.7 By 31 July 2012, each distributor would receive an independent expert's draft report on the compliance of the distributor's pricing methodology against the pricing principles, and should respond on the findings of the draft report by 30 September 2012. A summary of the independent reviews would be published by 30 November 2012, with a score for compliance with the pricing principles.
- 5.3.8 Subsequent reviews by an independent expert of a distributor's reporting against the pricing principles will occur only when a distributor amends its pricing methodology.
- 5.3.9 Due to the comparatively stable nature of distribution pricing structures, the Commission considers that an annual review of all distribution pricing methodologies is not justified. However, distributors are still required to publish their distribution pricing methodologies on an annual basis and provide details of any changes within one month of the change, as required by the information disclosure requirements under part 4 of the Commerce Act.
- 5.3.10 Where a distributor amends its methodology, the Commission has the discretion to initiate a review of the amended methodology.
- 5.3.11 The intention of the reviews of the distribution pricing methodologies is to improve the efficiency of distribution pricing, facilitate retail competition and enhance the quality of information disclosure.
- 5.3.12 If, at any time, a distributor had not provided sufficient information or was materially non-compliant with the pricing principles, the distributor would be persuaded to comply.
- 5.3.13 If there was no improvement in a distributor's compliance with the pricing principles, targeted regulation could be considered as another option, if was appropriate. It is the Commission's expectation that distributors will voluntarily

comply because the Commission has adopted many of the significant suggestions put forward by distributors on its approach to distribution pricing.

- 5.3.14 The Commission considers that this is an opportunity for distributors to demonstrate that a light-handed approach will result in improvements in the way distributors set their prices. Therefore, improvements will need to be demonstrated in a transparent manner so that it could be confirmed that distributors have set, or are in the process of setting, their prices in accordance with the pricing principles.
- 5.3.15 In future, distributors will be required to disclose under both the information disclosure guidelines and the Commerce Commission's part 4 information disclosure requirements each year. It is expected that the information disclosure guidelines will inform the Commerce Commission's deliberations on its disclosure regime.²⁴ It is also expected that the information disclosed under the information disclosure guidelines will be the same as the information disclosed under part 4. Therefore, distributors will be required to prepare one set of information for the two disclosures.
- 5.3.16 In summary, the timetable and process are:
- (a) the Commission publishes the final distribution pricing principles and information disclosure guidelines (February 2010);
 - (b) distributors use the information disclosure guidelines to report against the pricing principles with a review to assess alignment (March 2011);
 - (c) possible decision on whether more standardisation of tariff structures is required (October 2011);
 - (d) formal review against the pricing principles using the information disclosure guidelines (March 2012);
 - (e) each distributor receives an independent expert's draft report on the compliance of the distribution pricing methodology with the pricing principles (July 2012);
 - (f) distributors respond to the Electricity Authority on the findings of the draft report (September 2012);
 - (g) the Electricity Authority publishes a summary of the independent reviews (November 2012); and
 - (h) subsequent reviews when a distributor amends its pricing methodology.

²⁴ The Commerce Commission will be reviewing the information disclosure requirements once input methodologies are set so the Part 4 information disclosure requirements for pricing may change.

5.4 Facilitating retail competition

- 5.4.1 One of the main benefits for developing a model approach is to facilitate retail competition by reducing the transaction costs faced by retailers competing for electricity consumers across multiple distribution networks.
- 5.4.2 In this context, the Commission notes that clause 45(2)(e) of the Electricity Industry Bill requires the proposed Electricity Authority to consider requirements for distributors to use more standardised distribution line tariff structures and use-of-system rules to address the retail competition issue raised in the Ministerial Review into Electricity Market Performance which recommended “the development of more standardised line tariff structures and use-of-system business rules to facilitate retail competition, particularly in smaller lines areas.”²⁵
- 5.4.3 In arriving at its final decision on a principles-based approach to distribution pricing, the Commission noted to what extent, retail competition might be enhanced by distribution pricing.
- 5.4.4 For example, MRP supported a principles-based approach but commented on the Second Consultation Paper that:
- “The problems electricity retailers face with entering small EDB network areas can be compounded by the diversity of electricity distribution tariff arrangements particularly in small networks with an inordinate number of tariff categories”.
- 5.4.5 And, in its submission on the Third Consultation Paper, MRP commented:
- “Where we believe greater prescription than the Electricity Commission is proposing is needed is on “low level elements.” Matters such as customer definition, number of tariff categories and complexity of tariff structures can have a substantial impact on transaction costs and retail competition, particularly in small EDB network areas.”
- 5.4.6 In its submission on the Third Consultation Paper, Vector commented:
- “Through-out this consultation process we have not heard evidence of any significant distributor-wide failing that has had a material impact on retail competition, apart from the desirability for alignment on nomenclature. At worst, there may be a handful of distributors that could economise on the number of tariffs they offer, but this concern is fairly isolated.”

²⁵ Ministerial Review into Electricity Market Performance, December 2009.

- 5.4.7 At the workshop on 12 October 2009,²⁶ Orion tabled what it considered were the priorities for a retailer considering entering a network area. These were given a weighting (shown in brackets)²⁷:
- (a) are there enough potential customers? (50);
 - (b) how rational is the existing retail pricing level? (20);
 - (c) can I manage the energy price risk? (20);
 - (d) what are the operating costs (e.g. meter reading)? (9); and
 - (e) what are the incremental distributor costs? (1).
- 5.4.8 At the same workshop, MRP set out its considerations for entering a new network, which it listed as “General” and “Distributor” related:
- (a) General:
 - (i) regionally targeted acquisition costs;
 - (ii) scale of target customer group;
 - (iii) market pricing and returns;
 - (iv) meter reading;
 - (v) variety of metering configurations.
 - (b) Distributor:
 - (i) fault servicing requirements;
 - (ii) legal agreements;
 - (iii) pricing.
- 5.4.9 MRP’s considerations are fairly representative of the perspectives of retailers and distributors. Accordingly, it is clear that distribution pricing is only one of a number of issues that affect retail competition and it is more of an issue in respect of the smaller networks. Although retail competition may be facilitated by a reduction in the number and complexity of tariffs (and the number of networks), this may not necessarily mean that tariffs should be standardised across all networks.
- 5.4.10 The standardisation of tariffs may not be necessary in respect of large networks where retailers can accommodate complexity due to the economies of scale. However, where there are competition issues in smaller networks with complex

²⁶ See papers at: <http://www.electricitycommission.govt.nz/opdev/transmis/distrib-pricing/index.html#workshop-october-2009>

²⁷ Note: the weightings were for demonstration purposes only and are not based on any survey data or similar.

tariffs,²⁸ some standardisation may be beneficial. Additionally, any reduction in the number and complexity of tariffs needs to be balanced against:

- (a) loss of cost reflectivity and the impact on utilisation of networks (allocative efficiency) and future network costs (dynamic efficiency);
- (b) transition costs (it is expected that customer tariffs would need to change over time to avoid rate shock) for distributors and retailers;
- (c) costs of designing a simple methodology to minimise the above two costs; and
- (d) greater price uncertainty for retailers from a prolonged period of price adjustments (assuming a lengthy transition period).

- 5.4.11 After assessing the submissions, the Commission considers that a light-handed approach is appropriate as the benefits from enhanced retail competition from standardised distribution pricing were not demonstrated to be greater than the costs.
- 5.4.12 Notwithstanding the absence of a definitive case for imposing greater prescription, the Commission considers that improving the quality of distribution pricing should reduce transaction costs. The reviews that will be conducted on distribution pricing methodologies will highlight the number and complexity of tariffs and should lead to guidelines for improvements, particularly in the smaller network areas.
- 5.4.13 The administrative issues (low level elements) such as relating to standardisation of nomenclature and information exchange have been addressed by the Distribution Pricing Administrative Issues Working Group. The Commission has several activities in hand to increase the level of standardisation in the reconciliation process and model use of system agreements. These activities will contribute to reductions in the transaction costs faced by retailers.
- 5.4.14 The reviews that will be conducted on distribution pricing methodologies will highlight the number and complexity of tariffs and should lead to guidelines for improvements, particularly in the smaller network areas. More standardisation of lines tariff structures will evolve from the reviews, which will highlight best practice and identify networks where pricing is inconsistent with the pricing principles.
- 5.4.15 In deciding on a principles-based approach to distribution pricing, the Commission has noted clause 45(2)(e) of the Electricity Industry Bill which requires the proposed Electricity Authority to consider requirements for distributors to use more standardised distribution line tariff structures and use-of-system rules. However, it is important to appreciate that the Commission's

²⁸ E.g. MRP's comments in section 5.4.4 of this paper.

decision on a principles-based approach does not purport to meet the requirements in clause 45(2)(e).

- 5.4.16 Hopefully however the work done in deciding on a principles-based approach will assist the proposed Electricity Authority in its consideration of any further work to be done in this area.

Appendices

Appendix 1 Response to questions posed in the Third Consultation Paper and Commission's comments on responses

Appendix 1 Response to questions posed in the Third Consultation Paper and Commission's comments on responses

| Submitter | Agree/ disagree | Response to question | Commission Comments |
|---|--------------------|---|---|
| Question 1 - Do you agree with the wording of these proposed principles? | | | |
| Domestic Energy Users' Network (DEUN) | Disagree | <p>Principle (a): Rejects the definition of "subsidy-free".</p> <p>Disagrees with the principle of charging the most captive consumers the highest prices.</p> <p>Disagrees with the replacement in Principles (c) and (d) of "users" by "stakeholders". This brings all Industry Participants inside the "regulatory tent", while specifically excluding consumers other than Industry Participants. The exclusion of domestic consumers is confirmed by one of the Commission's responses: "The generic term "stakeholder" has been introduced to cover all affected parties." [That is, domestic consumers are not 'affected'].</p> <p>In Principle C (iii), the idea of encouraging investment in transmission or distribution alternatives, including distributed generation and demand response, is qualified by "where network economics warrant". This is a sop to the industry. Alternatives should be encouraged wherever the overall economics warrant, not where network economics warrant.</p> <p>Principle (e) of the earlier discussion document referred to "retailers" and "consumers"; the consultation document deleted "consumers". Rejects that deletion because consider the Electricity Authority cannot ignore the needs of domestic consumers.</p> | <p>Noted.</p> <p>Noted.</p> <p>The Commission uses "stakeholders" as an all inclusive term. Consumers (including domestic consumers) are affected by distribution pricing.</p> <p>Disagree. The Commission does not wish distributors to encourage uneconomic alternatives to network investment through distribution pricing.</p> <p>The amendment was meant to emphasise the need to encourage retail competition by reducing transaction costs on retailers. This will benefit consumers. The Commission agrees with the suggestion to restore "consumers" and is also adding "and other stakeholders". This will retain the</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
|---------------------------|--------------------|---|--|
| | | | focus on retailers and ensure that distributors have regard to the impact of transaction costs on other parties. It will also confirm that consumers are also stakeholders. |
| Mighty River Power | Partial | <p>The pricing principles (a) to (c) basically state that pricing methodologies should be cost reflective and subsidy free. Think there is a real risk the principles (a) to (c) that they will be interpreted as indicating that greater tariff disaggregation and greater tariff complexity should be adopted to ensure tariffs are fully cost-reflective and subsidy free. This would be a retrograde step.</p> <p>Believe that for the Electricity Commission to determine principles (a) to (c) are being met would require an extensive amount of information from each of the EDBs which goes way beyond the apparent independent review process the Electricity Commission is proposing. A good example of this is the information requirements imposed by the Commerce Commission on Unison, Vector and Powerco, as part of its Part 4/4A Commerce Act responsibilities, during investigations into whether it should invoke price control and what form that price control should take.</p> <p>Principle (d) suggests pricing should be transparent and promote price stability and certainty. Any pricing methodology can achieve this so long as the methodology is disclosed and prices aren't changed on a regular (more than annual) basis. Principle (d) also suggests "changes to prices should have regard to the impact on stakeholders" but this probably isn't specific enough to provide EDBs with much guidance.</p> <p>Principle (e) gets more to the heart of concerns stating that "Development of prices should have regard to the impact of transaction costs on retailers". However, it would appear principle (e) is sub-ordinate to the other principles as EDBs are only required to "have regard to" it. If principles (a) to (c) are given greater weight this could actually drive greater tariff complexity. Principle (e) goes on to suggest that prices "should be economically</p> | <p>Noted.</p> <p>The initial review should test the information requirements.</p> <p>Noted. It may be necessary to develop guidelines on the types of impact that distributors should have regard to after the initial review of pricing methodologies.</p> <p>The principle has equal weight with all other principles. Distributors should "have regard to the impact of transaction costs" but will be expected to adopt the principle and not just</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
|-----------------|--------------------|--|--|
| | | <p>equivalent across retailers”. Any pricing methodology should achieve this as long as they are not discriminatory.</p> <p>Believes it would be helpful if, at the very least, the Electricity Commission included as principles, or key measures it will rely on to determine if the principles had been appropriately adopted that, notwithstanding any of the other principles, the Electricity Commission expects:</p> <ol style="list-style-type: none"> a. EDBs to adopt a single (contiguous network) tariff area; b. there to be a reduction in tariff categories/complexity; and c. the smaller the EDB the simpler the pricing methodology will be and the less tariff categories that will be adopted | <p>“have regard to” it.</p> <p>The Commission agrees that these would be desirable features that adherence to the principles should encourage.</p> |
| Meridian | Agree | Happy with the wording of the proposed principles. These principles appear to remain satisfactory for the development of required simplified tariffs. | Noted. |
| Contact | Disagree | <p>Considers the pricing principles are still unlikely to deliver outcomes that address retailers' key concerns, and proposes some subtle but important amendments to (d) and (e).</p> <p>Retailers' key requirements are:</p> <ul style="list-style-type: none"> • Stability in pricing structure, not changing year on year, but acknowledging that from time to time structural changes are necessary to ensure appropriate network pricing signals to consumers. e.g. once smart metering is widely deployed it will lead to changes such as additional time block and/or demand pricing for mass market consumers. • Prices should be predictable and provide certainty for retailers such that the line prices can be passed through to consumers without repackaging and retrospective adjustments. This will also enable more effective transparency of line prices to | <p>Noted.</p> <p>Noted.</p> <p>Noted.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
|-----------|--------------------|---|--|
| | | <p>consumers where demanded by consumers.</p> <ul style="list-style-type: none"> All charges should be included in prices. <p>Principles (d) and (e) appear to be intended to cover these principles, but miss the mark, largely because "Development of prices should" does not in our view cover the "prices" themselves and "price structure" which are most important to retailers.</p> <p>"Development of prices should be transparent" is fine given the use of "transparent" is apparently retained to reinforce the concept behind the information disclosure requirements that apply to the pricing methodologies, and development of prices.</p> <p>Given the above comments we would suggest the following would be more useful to retailers and consumers for (d) and (e):</p> <p>"(d) Development of prices should be transparent and have regard to the impact of transaction costs on retailers by promoting price structure stability.</p> <p>(e) Prices should be predictable and provide certainty for retailers to enable pass through without the need for repackaging or retrospective billing adjustments, and be economically equivalent across retailers."</p> | <p>Noted.</p> <p>Disagree. "Development of prices" relates to the pricing methodology which is how prices are structured and how price levels are derived from costs.</p> <p>Noted.</p> <p>Disagree as this is too prescriptive and limits the range of features that have an impact on transaction costs.</p> <p>The Commission agrees that the suggested features would be desirable but considers that the suggestion is too prescriptive. Having regard to the</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p><i>Comments:</i></p> <ul style="list-style-type: none"> • "without the need for repackaging" covers the need for all charges to be included in prices, and transparency of line prices where demanded by consumers. • "without the need forretrospective billing adjustments" covers the concern that neither consumers nor retailers like retrospective billing adjustments due to need to recover line costs that were not predictable/certain/known until after the initial billing. • (e) is clearly only relevant to retailers (not stakeholders) in an interposed relationship, a conveyance only arrangement involving direct billing of line charges (e.g. The Lines Company) will by default mean line prices are predictable/certain to consumers as they will be on their bill. • "having regard to the impact of transaction costs by promoting price structure stability" is a product of "development of prices", and it is the regular changes to price structure and overly complex price structure that predominantly causes additional transaction costs for retailers. | <p>impact of price changes and transaction costs should lead to reductions in the repackaging and retrospective impacts of pricing among other improvements.</p> |
| Powershop | Agree | <p>Supports the proposed pricing principles. Also suggests that 'principle d' should capture the concept of cost certainty. By 'cost certainty', mean pricing structures that give certainty over the cost of using a unit of lines services at a particular time so that can determine the cost of services that may be used by a customer ex ante.</p> | <p>The principle requires that the distributor promote "price certainty", which would provide cost certainty for retailers.</p> |
| TrustPower | Partial | <p>Cross subsidies are inevitable where it is impractical to reflect the true cost of supply due to limitations of metering or control equipment. Principle (a) (i) should be amended to allow subsidies where it is not practicable to accurately reflect the true cost of additional usage on future investment costs. This would be achieved by simply adding the words "or an inability to practically apply the cost of additional usage on future investment costs as detailed in</p> | <p>The range between incremental costs and standalone costs should allow for pragmatism in allocation of costs.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>(iii)” at the end of the paragraph.</p> <p>Principle (e) no longer reflects the cost to the consumer where Network Companies vary their pricing structure over time and the consumer has invested in appliances or control equipment to take advantage of the signals offered. The principle needs to ensure that prices are predictable and provide certainty for retailers and consumers. The Line prices should enable consumers to respond to pricing signals and be able to be passed onto consumers without the need for rebundling.</p> | <p>The amendment was meant to emphasise the need to encourage retail competition by reducing transaction costs on retailers. This will benefit consumers. The Commission will restore “consumers” and add “and other stakeholders”. This will retain the focus on retailers and ensure that distributors have regard to the impact of transaction costs on other parties.</p> |
| <p>Wellington Electricity (WELL)</p> | <p>Partly Agree</p> | <p>For (c) iii. suggest the following revision to the wording:</p> <p><i>“where network economics warrant <u>and to the extent practicable</u>, encourage investment in <u>transmission and</u> distribution alternatives (e.g. distributed generation or demand response) and technology innovation.”</i></p> <p>The capability of distribution pricing to influence transmission alternatives is limited. Whilst EDBs can influence new local transmission connection costs they cannot influence transmission pricing in relation to sunk transmission assets. The extent to which transmission pricing encourages transmission alternatives is beyond the control of EDBs.</p> <p>Making the above amendment with respect to ‘practicality’ acknowledges that other regulations such as the Distributed Generation Regulations have been promulgated to ensure distributed generation is not disincentivised. Whilst encouraging investment in distribution alternatives may be desirable, there will be a network cost to facilitate the alternative and it will not always be practical or economic from a network perspective to</p> | <p>Agree that “and to the extent practicable” be included in the principle.</p> <p>Disagree with the deletion of “transmission and”. Distribution pricing will have an influence on end use behaviour and where the distributor can see that a transmission reinforcement can be deferred through end use incentives, it would be in the interests of consumers on the network that these incentives be offered. Transmission pricing will provide pricing signals and distributors should</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>have alternatives to distribution.</p> <p>Electricity distribution is a proven technology which is more reliable and secure than current alternatives.</p> <p>For (d) suggest the following wording revision:</p> <p><i>“Development of prices should be transparent, promote have regard for price stability and certainty for stakeholders and changes to prices should have regard to the impact on stakeholders.”</i></p> <p>Considers that stability and certainty, while desirable are not always possible, particularly given the dynamic and innovative changes required to achieve other objectives including ‘subsidy free’</p> | <p>pass these on.</p> <p>Current alternatives include load management which has been a major contributor to the economic management of distribution networks for decades.</p> <p>Disagree with the proposal. It is clear from submissions by retailers and consumers that volatility, particularly with pricing structures, increases costs and risks. Distributors should, where options exist, promote stability and certainty.</p> |
| Orion | Agree | Pleased to see that the Commission has proposed a principles-based approach to distribution pricing, underpinned by information disclosure. Fully endorse this approach | Noted. |
| Pricewaterhouse Coopers (PWC) | | Principle(c): Support the use of the term "stakeholders" rather than "users" throughout the principles, which is a more inclusive term. Do not support the continued reference to "price/quality trade-offs" or "non-standard arrangements". Neither of these terms is defined (or the implied alternative "standard arrangements") and they may mean different things to different EDBs or stakeholders. Believe the existing wording 'economic value of specific services' is sufficient. It is also more valid, as it links the service requirement to its value, which is the appropriate principle to underpin pricing. The concept of negotiation is also useful, as it reflects the reality of setting service standards for those consumers which are | Noted. Do not agree that the terms “price/quality trade-offs” or non-standard arrangements” need to be defined as they have been in common usage in the industry. |

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| | | <p>able to consider possible alternatives.</p> <p>Do not support the inclusion of the proposed principle (iii). These concepts are already covered by other forms of regulation. The CC is developing explicit regulatory mechanisms to address energy efficiency, to ensure EDBs are not disincentivised from investing in energy efficiency initiatives. Distributed generation is adequately covered by the Distributed Generation Regulations and inclusion of this requirement in a pricing methodology principle is confusing, excessive and creates potential inconsistencies in the regulations applying to EDBs.</p> <p>Distribution alternatives and technology innovation are not objectives which are readily achieved through pricing methodologies, but they are objectives which can be disincentivised by overly prescriptive regulation. Innovation, including possible distribution alternatives, is best dealt with through the price-quality path and is being explicitly considered by the CC as it develops its efficiency carry over mechanisms and CPI-X regime. In addition the uneconomic bypass requirement in (i) already addresses this requirement.</p> <p>Principle (d): There is no need for the transparency requirement which is superfluous as this is what the disclosures themselves will achieve. We support the remaining amendments as transitioning new pricing structures is an important component of any pricing methodology.</p> | <p>As far as practicable, the Commission wishes the principles to stand alone and reflect the objectives it is mandated to achieve.</p> <p>A pricing methodology that encourages load management can lead to innovation in technology. The distribution system in new Zealand has used ripple control to reduce investment in networks for decades.</p> <p>The transparency of pricing methodologies is an essential component of the principles and the principles should stand alone.</p> |
| WEL | Agree | Agree | Noted. |
| Vector | | <p>Broadly supports the latest set of pricing principles.</p> <p>Amend Principle (c)(iii) as follows: where network economics warrant <u>and to the extent practicable</u>, encourage investment in transmission and distribution alternatives (e.g.</p> | Agree that “ and to the extent practicable ” be included in the |

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| | | <p>distributed generation or demand response) and technological innovation. Will align this principle with others and reinforce the point above by allowing a level of practicality - it will be difficult to design a pricing regime that could support all types of distribution alternatives.</p> <p>Does not consider that distributors should be responsible for promoting transmission alternatives. Guideline B(v) of the proposed Information Disclosure Guidelines elaborates on this principle by explaining that pricing arrangements should share the value of any deferral of investment in transmission with the investors in the alternative. If there is a deferral of transmission investment then any avoided transmission payments should be dealt with by Transpower's pricing arrangements, not distributors', as Transpower and other investors will ultimately have the power to decide on whether to build transmission or not. Transmission alternatives should therefore, not be included in this principle.</p> <p>Principle (e): The impact of transaction costs on retail competition that arise through distribution pricing has been somewhat overstated, so it is concerning that the Government seems to only be requiring standardisation of distribution pricing in the Electricity Industry Bill to presumably target this perceived retail competition problem. This ignores the fact that there are a range of other pricing objectives that distributors need to consider (as the full set of pricing principles illustrates).</p> <p>Furthermore, through-out this consultation process have not heard evidence of any significant distributor-wide failing that has had a material impact on retail competition, apart from the desirability for alignment on nomenclature. At worst, there may be a handful of distributors that could economise on the number of tariffs they offer, but this concern is fairly isolated.</p> | <p>principle.</p> <p>Disagree with the deletion of "transmission and". Distribution pricing will have an influence on end use behaviour and where the distributor can see that a transmission reinforcement can be deferred through end use incentives, it would be in the interests of consumers on the network that these incentives be offered. Transmission pricing will provide pricing signals and distributors should pass these on.</p> <p>Noted.</p> |

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| | | Ultimately we accept the inclusion of the "impact of transaction costs on retailers" in this pricing principle but only as a consideration amongst other pricing principles. | |
| Unison | Agree | <p>Supports the Commission's proposed pricing principles contained in the Consultation Paper. Such an approach will better enable distributors to provide innovative pricing arrangements to encourage more efficient use of networks and promote improvements in economic efficiency.</p> <p>Welcomes the amendments that the Commission has made to the principles since the last consultation paper; for example allowing EDBs to comply with the requirements "to the extent practicable". Support such an approach in respect to EDB compliance to the principles, as it takes into account the inevitable limitations on EDBs trying to achieve a workable tariff structure. Commends the Commission for the inclusion in principle (c), that the benefits of distributed generation are only to be taken into account to the extent warranted by the economics of the individual network.</p> | Noted. |
| Powerco | Agree | <p>Main concern is that under Commerce Commission regulation, EDBs may not achieve an adequate return on investment if they persuade customers to reduce electricity volumes. Consequently Powerco is limited in what it can do [...].</p> <p>Recommend "to the extent practicable" is added to the principle to recognise this, resulting in the principle that, "C)... (iii) where network economics warrant and to the extent practicable, encourage investment in transmission distribution alternatives (e.g. distributed generation or demand response) and technological innovation."</p> | <p>Noted.</p> <p>Agree that "and to the extent practicable" be included in the principle.</p> <p>Disagree with the deletion of "transmission and". Distribution pricing will have an influence on end use behaviour and where the distributor can see that a transmission reinforcement can be deferred through end use incentives, it would be in the</p> |

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| | | <p>Uncertain how principle (e) will be interpreted (“Development of prices should have regard to the impact of transaction costs on retailers and should be economically equivalent across retailers”). It would be very difficult for Powerco to calculate the impact of its pricing on retailers. Instead would refer to consultation with retailers and how it has taken their feedback into account on pricing proposals.</p> <p>Would expect to demonstrate that line charges are economically equivalent by having one pricing schedule that applied to all retailers. If the Commission deems this to refer to something else it should specify this. For example, it could mean that any price change (applying to all retailers) must not disadvantage one retailer over another. This would be near impossible to comply with as retailers’ customer bases and operating practices differ so much.</p> <p>Recommends that the principle is changed to: Development of prices should have regard to the impact of transaction costs on retailers and should be economically equivalent economic equivalence across retailers.</p> | <p>interests of consumers on the network that these incentives be offered. Transmission pricing will provide pricing signals and distributors should pass these on.</p> <p>If necessary, the Commission will develop guidelines on the range of impacts that distributors should have regard to.</p> <p>One pricing schedule that applied to all retailers meet the principle, provided that the pricing schedule applied to all retail operations in a manner that was non-discriminatory (i.e. different retailers are not charged different prices for substantially the same service, rendered under similar conditions) and that “all retailers” included any retail operation that the distributor operated.</p> <p>The Commission does not think that the suggested amendment to principle ‘e’ is required.</p> |

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| Question 2 – Do you support the concept of information disclosure guidelines rather than the more prescriptive methodological requirements? | | | |
| DEUN | Disagree | Rejects the document’s proposed reliance on guidelines instead of prescribed methodologies for information disclosure. Poorly defined information disclosure led to extensive manipulation during the 1990s of lines company accounts, enabling massive transfers of wealth from consumers to lines companies | If at any time the Commission considered that a distributor had not provided sufficient information or was materially non-compliant with the principles, it would seek to persuade the distributor to comply. If there was no improvement, the Commission would consider targeted regulation. |
| Meridian | Disagree | Does not support guidelines for distribution pricing over more prescriptive methodological requirements. Guidelines for distribution companies have not yet had any discernable effect, and there is no reason to expect they would have an effect now. | See above. |
| Powershop | Agree | Support this approach. | Noted. |
| WELL | Agree | Supportive. Guidelines are much more desirable than prescriptive methodological requirements. | Noted. |
| Orion | Agree | In general agree with the proposed information guidelines | Noted. |
| PWC | Agree | Support the proposal to abandon the proposed methodological requirements which are inconsistent with a principle approach to distribution pricing methodologies. As previously submitted any guidance on pricing methodologies must be consistent with the Electricity Distribution (Information Disclosure) Requirements (IDRs) as prescribed under Part 4 of the Commerce Act 1986. | Noted. |

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| WEL | Agree | Support the concept of information disclosures. | Noted. |
| Vector | Partial | Supports the concept of non-mandatory Information Disclosure Guidelines (the "guidelines"). However, are some areas of the guidelines which could be improved. | Noted. |
| Unison | Agree | Supportive of the alignment of the guidelines to the Commerce Commission's preliminary view on the direction of the information disclosure requirements. Consider that mandatory methodological requirements are unnecessary. It is more appropriate for the Commission to provide non-mandatory guidelines to assist EDBs in regards to what should be contained in their pricing methodology disclosures. | Noted. |
| Powerco | Agree | Supports information disclosure guidelines and opposes more prescriptive methodological requirements. | Noted. |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| Question 3 Do you agree with the wording of these proposed information guidelines? | | | |
| Powershop | Agree | Agree with the proposed wording. | Noted. |
| WELL | Agree | Broadly supportive. Expect these to be aligned with the requirements of the Commerce Commission and going forward expect the EC and its successor organization to work with the Commerce Commission to ensure these requirements do not diverge. | Noted. |
| Orion | Partial | <p>Guideline (a) could be more clearly expressed as “<i>Prices should be based on a well defined, clearly explained methodology, with any <u>material</u> revisions <u>to the methodology</u> notified and clearly marked.</i>” to make it clear that it is the methodology changes that need to be marked, not the price changes or the routine changes in quantities that occur each year. This point is acknowledged by the Commission, at least in relation to changes to prices, at paragraph 4.1.7 of the paper which states “Changes to price levels need not be reported.”</p> <p>Guideline (c) (i) should be expressed as “<i>employ industry standard <u>terminology</u> tariff formats and nomenclature, where possible;</i>” as it is the methodology that is the subject of the guidelines, not the format of the pricing information.</p> | <p>Agree with the proposed clarification.</p> <p>Agree.</p> |
| PWC | Partial | <p>Guideline (a) is superfluous and do not support its inclusion. This is the disclosure requirement, i.e.: to publish a methodology and any revisions to it. It should not form part of the guidelines.</p> <p>Guideline (b) : Amend to: “The pricing methodology disclosed should <u>demonstrate.</u>”</p> <p>Guideline (b)(i): Delete “and any non-compliance”. The term non compliance is ambiguous and unnecessary. There will be a legislative requirement for the pricing methodologies to comply with the principles. Any assessment of non compliance will occur following independent review, not by the EDBs themselves.</p> | <p>Disagree. It is a succinct statement of the purpose of the guidelines.</p> <p>Agree.</p> <p>Disagree. The Commission would like to see the distributor’s own assessment of its compliance and notes on any non-compliance.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>Guideline (b)(ii): Support this component of the Guidelines</p> <p>Guideline b(iii): Delete “and revenue”. It is the allocation of costs to consumer groups which is required to support a pricing methodology, not revenues. Revenues are the outputs of the prices (and associated quantities).</p> <p>Guideline (b)(iv): Support this component of the Guidelines</p> <p>Guideline (b)(v): Propose <u>An explanation of the derivation of the tariffs to be charged to each consumer group and the rationale for the tariff design</u>. The proposed guidelines miss the step in the pricing methodology which converts cost allocation into tariffs, for each customer group.</p> | <p>Noted.</p> <p>Disagree with the deletion. Agree that revenue is the output of prices and volumes. Prices are determined by the allocation of the revenue requirement to each consumer group. The key components of both costs and revenue are required to support a pricing methodology. This guideline is consistent with the disclosure requirements in the Commerce Act, <i>“Describe the method by which the disclosing entity allocated the components of the revenue required to cover the costs of its line business activities amongst consumer groups “</i></p> <p>Noted.</p> <p>Agree.</p> |
| PWC | | <p>Delete Guideline (b)(vi): Do not support this requirement, as do not support the proposed principle (c)(iii) - reasons outlined previously. In addition, the sharing of any investment deferral benefits arising from distributed generation typically forms part of a commercial contract negotiated between the distributor and the generator. It is not appropriate for the details of such contracts to be publicly disclosed. This is adequately covered by the</p> | <p>The Commission has not requested the public disclosure of the commercial arrangements.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>Distributed Generation Regulations (refer Schedule 4 Pricing Principles)</p> <p>Guideline (c)(i): Delete “employ industry standard tariff formats and nomenclature, where possible: and”. There is no definition of what these are and no discussion of these in the Consultation Paper. This cannot therefore be complied with and should be removed, unless further clarification and direction is provided.</p> <p>Guideline (c)(ii). Amend to:</p> <p><i>i. where a change to the existing previous pricing methodology is proposed-implemented describe the details-of impact on consumer classes and the transition arrangements proposed-implemented to mitigate the effect of redistribution of costs and rate shock introduce the new methodology.</i></p> | <p>Agree that this guideline should be modified and the Commission has accepted the Orion suggestion to replace “tariff formats and nomenclature” with “terminology”. The Commission will expand the guideline if additional explanation is required.</p> <p>Agree.</p> |
| WEL | Agree | Agree | Noted. |
| Vector | Partial | <p>Guideline b(i): reiterates that strict compliance against each individual pricing principle is not always possible as the principles often have competing aims and need to be weighted and considered in a holistic fashion with other pricing objectives. Accordingly, reiterate that "compliance" should mean having regard to the pricing principles in pricing analysis and decision-making.</p> | <p>Agree that there can be competing objectives and that a holistic approach needs to be taken in assessing the methodology but any conclusion would take into account the performance against each principle, and how competing objectives have been reconciled.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>Amend guideline b(iv): “the rationale for consumer groupings and the method for determining the allocation of consumers to each consumer grouping;” The method for determining the allocation of each consumer grouping is likely to be covered off in the explanation of the cost-allocation methodology.</p> <p>Guideline b(v) - does not agree that transmission alternatives should be included in distribution pricing. The phrase "where network economics warrant" should also be included to align it with the corresponding pricing principle and prior arguments we make on incentives mechanisms.</p> | <p>Disagree with the proposed change. The method for determining the allocation of consumers to each consumer grouping is an important aspect of the pricing methodology and may not be covered in the explanation of the cost allocation methodology.</p> <p>Agree with the proposal to add “where network economics warrant”.</p> |
| Unison | Partial | <p>Would like to recommend the following minor amendment to guideline (a) to ensure clarity:</p> <p>(a) Prices should be based on a well-defined, clearly explained and published methodology, with any <u>material</u> revisions <u>to the methodology</u> notified and clearly marked.</p> | Agree. |
| Powerco | Partial | <p>Supports the information disclosure guidelines, although have some concerns on wording.</p> <p>The wording of the final instructions of how EDBs should report against the principles is important. Uncertain of the level of evidence the independent reviewer will require to judge if the relevant principle has been taken into account. Would mainly demonstrate compliance by: explaining how the principles have been considered in pricing; describing the trade-offs; and giving examples as supporting evidence. It would be unrealistic to expect EDBs to provide a formula or model that tracks costs and trade-offs through to prices as there are too many variables to take into account.</p> <p>As an example of level of evidence required, there are a range of techniques the submitter could use to calculate incremental cost and stand alone cost. As the subsidy free zone is significant, should not have to invest in extensive modelling and analysis to improve the</p> | <p>Noted.</p> <p>Noted.</p> <p>Agree.</p> |

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| | | <p>accuracy of this estimation.</p> <p>An approach could be to deem the marginal cost to equate to the cost to connect a customer from their meter to an electricity line. This was the approach taken by Vector in the Gas Authorisation.</p> <p>To accurately estimate standalone cost would need to calculate an ODV for each class of customer, which would be a substantial undertaking. Still considering the most cost effective way to estimate stand-alone costs for classes of customer and recommends the Commission allows for wide estimations.</p> | <p>Agree.</p> <p>Noted.</p> |
| | | <p>In the Gas Authorisation process the addition of the words “to have regard to” were helpful in providing guidance and recognised the issues with providing information and trade-offs between principles. Showing compliance with the principles required giving genuine attention to consideration to the principles in the pricing process and making decisions, in a transparent manner, which were appropriate and practical. We recommend (b) is changed as follows: The pricing methodology disclosed should include sufficient information on the following for the independent expert to assess the extent to which regard has been shown to compliance the pricing principles [...]</p> <p>Concerned about the requirement to provide “an explanation of the cost allocation methodology”. Prefers the text in the Commerce Commission Information Disclosure Requirements, “23(d) Describe the method by which the disclosing entity allocated the components of the revenue required to cover the costs of its line business activities amongst consumer groups.”</p> | <p>Disagree with the proposed change. The Commission wishes to see the level of compliance with each principle not the extent to which regard has been shown to it.</p> <p>Noted.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| Question 4: Do you agree with the proposed process and timetable for reporting? | | | |
| Meridian | Disagree | <p>Supports the proposed process for reporting.</p> <p>Considering the decisions in the Ministerial Review and the subsequent timeframe in the Electricity Industry Bill for rules requiring lines companies to simplify tariffs, this reporting timeframe may need to be revisited.</p> | Noted. |
| Powershop | Agree | Agree with the proposed process and timetable for reporting. | Noted. |
| WELL | Disagree | <p>Note that the Commission proposes to publish final pricing principles in February 2010. EDBs will only have two months to consider the principles and potentially modify their methodologies accordingly. Does not consider this to be a realistic timeframe given the complexity of the issue. Implementation of the principles and the review of their compliance should be delayed for at least 12 months to the subsequent regulatory period to enable adequate time for EDBs to work through the issues.</p> | Noted. The Commission will revise the proposed approach in relation to the objectives of the first review. The first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period. |
| Orion | Partial | <p>Agree that each EDB will be required to publically disclose its pricing methodology under requirement 22 of the Original requirements and that the contents of the pricing methodology so disclosed must satisfy requirement 23. Also agree that it may be informative for both the Commission and EDBs, as a learning exercise, to have an independent expert report on the compliance of each EDB's pricing methodology with the pricing principles by 31 July 2010, and to produce a summary of those reports.</p> <p>Do not agree that any useful learning can be achieved for either the Commission or EDBs by carrying out the step of EDBs reporting on the expert's findings to the Commission by August 2010. This is because EDBs will almost certainly have published new prices, and possibly also the associated pricing methodologies based on their current practices, before the pricing principles are finalised and published in February 2010. It does not seem</p> | <p>Noted.</p> <p>Agree. The Commission will revise the proposed approach in relation to the objectives of the first review</p> <p>The first formal review against the</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>appropriate or reasonable to require distributors to respond to an assessment against the new pricing principles, given that their current pricing methodologies will not have been specifically designed to comply with those principles. Therefore recommend that the first formal assessment and review of the pricing methodology disclosures against the principles be carried out in relation to those made for the April 2011 to March 2012 year.</p> | <p>principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |
| PWC | Partial | <p>The proposed compliance process is unworkable because it will not be possible for EDBs to disclose pricing methodologies consistent with the new pricing principles by 1 April 2010. If this project is to add any real value to the electricity market, distributors must have time to consider the new principles, review their existing pricing methodologies, make changes to their existing pricing methodologies to better reflect the new principles if necessary, consult with consumers and other stakeholders, develop a transition plan, and draft and publish a new pricing methodology. This is not something that can be, nor should be, achieved by the beginning of the next pricing period on 1 April 2010.</p> <p>The principles will not be published at the time EDBs are required to notify their prices for the coming year to Retailers. EDBs are already well advanced in developing their prices for the pricing year commencing on 1 April 2010. It is not possible to retrospectively impose new principles into this process and accordingly the first pricing methodology disclosures consistent with the new principles must be, at the earliest, for the pricing period commencing 1 April 2011. This timetable also allows for the consultations on the Commerce Act Part 4 Input Methodologies and the Electricity Industry Bill to have progressed.</p> <p>Pricing methodology disclosures for the 1 April 2010 pricing period should continue to be disclosed according to the provisions of Requirement 23 of the IDRs. The preparation of these disclosures is already well advanced as EDBs are close to finalising their prices for the forthcoming period.</p> <p>The EC proposes that periodic reviews of pricing methodology disclosures are undertaken to assess compliance. Support a review process to assess compliance, identify best practice and assist EDBs to improve their disclosures. Agree that it will be unnecessary to</p> | <p>Noted.</p> <p>Agree.</p> <p>Agree.</p> <p>Noted.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>undertake reviews every year, and agree with the suggestion that following an initial review of all disclosures, reviews may be limited to those EDBs which implement significant changes to tariff structures and pricing methodologies.</p> <p>Do not support the suggestion that the first review be a benchmarking exercise. It is not an appropriate objective for the review report to publish a ranking or league table of pricing methodologies. Pricing methodologies will by necessity be descriptive and contain a significant amount of explanatory information. They will also necessarily reflect the particular circumstances facing each distributor including existing tariff structures, transition arrangements and network characteristics and challenges.</p> <p>Do not support a relative assessment which will require subjective judgements. Do support identification of best practice and areas for improvement. This is where the value will be added to the industry. Not through a subjective league table.</p> <p>Do not support the proposed timing of the initial review. For the reasons outlined above the pricing principles can only be incorporated into pricing for the 1 April 2011 year for the first time. Therefore the first review can only occur in 2011 at the earliest, not 2010 as suggested in the Consultation Paper.</p> <p>Support the intention for the EC to attempt to persuade EDBs to improve compliance where areas of non compliance or poor compliance are identified during a review.</p> | <p>Noted. The Commission will revise the proposed approach in relation to the objectives of the first review.</p> <p>Noted.</p> <p>Agree the first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> <p>Noted.</p> |
| Northpower | Disagree | <p>The proposed commencement for information disclosure and review from 1 April 2010 onwards is premature. The process of consulting with retailers and notifying line charges which will be effective from 1 April 2010 has already commenced, consistent with the requirements of the Commission's Model Use of System Agreement (MUoSA).</p> <p>In addition, the MUoSA only permits one price/tariff review per 12 months. Furthermore, the Rules relating to Price Category Codes require changes to Price Category Codes to be notified to the Registry and to the Commission at least two calendar months prior to the</p> | <p>Noted. The Commission will revise the proposed approach in relation to the objectives of the first review</p> <p>The first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | effective date which, for 1 April 2010, would be 31 January 2010. Therefore commencement date for information disclosure and review should be 1 April 2011 | |
| ENA | Disagree | <p>Do not support the proposed timetable as it is not able to be achieved. Distributors are about to finalise their pricing for the forthcoming pricing year commencing on 1 April 2010. If as proposed, the new principles are to be published in February 2010, the first time these will be able to be included in pricing will be for the following pricing year, commencing 1 April 2011.</p> <p>The [information disclosure] requirements focus on the calculation methodologies used by EDBs not the underlying pricing principles that have been used to determine the structures and levels of charges. Accordingly, an expert review of pricing methodology disclosures made at 1 April 2010 will simply identify that it is unclear to what degree distributors' pricing methodologies comply with the proposed principles, since the information will not exist to make an informed assessment. We therefore submit that it would be premature and needless waste of resource to review disclosures made pursuant to the current requirements.</p> | <p>Noted. The Commission will revise the proposed approach in relation to the objectives of the first review</p> <p>The first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |
| WEL | Agree | Agree | Noted. |
| Vector | Partial | <p>Broadly supportive of the proposed Pricing Methodology Review process as the primary vehicle by which compliance with the pricing principles is assessed.</p> <p>Concerned about what the role of the independent reviewers should be: Submits that the independent reviewer's role should be to assess the extent to which distributors "have had regard to" the pricing principles. Showing compliance against pricing principles in the context of the Gas Authorisation meant giving genuine attention and thought to the principles during the pricing analysis and decision-making process, and such weight as is considered to be appropriate and practical. This recognised the competing tensions between the various pricing principles and other pricing objectives, and the need for a</p> | <p>The Commission wishes to see the extent to which each principle has been applied and not just the extent to which it has been considered or to which distributors have had regard to it.</p> <p>Agree that there can be competing</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>holistic pricing approach. To that end, it is the robustness of the analysis and decision making process that needs to be assessed by the independent reviewer, not strict compliance against each principle.</p> <p>Concerned about when reporting and review should first take place: Particularly concerned about distributors being required to report against the pricing principles for the 1 April 2010 - 21 March 2011 ("2010/11") pricing year. This information would be meaningless as a benchmarking exercise as it is impractical from a timing perspective to show regard to the pricing principles. Many distributors have already finalised prices for next year and have not had the opportunity to explicitly consider the pricing principles. Consequently, submitter would be forced to state that we have not shown explicit regard to the principles, (albeit to varying degrees the principles have implicitly underpinned the ongoing development of our tariff structures).</p> <p>Submits that, as always, rules and regulations should be forward-looking and any review should apply to prices that have been set with full knowledge of the requirements. Accordingly, believes that the first year of compliance should be 2011/12.</p> <p>The proposed time-line for the review process seems appropriate for use in the first year and in subsequent years. Particularly support distributors being given the opportunity to respond to the independent reviewer's findings before being made public. However, believes that it would be more reasonable for the Commission to extend the timeframe for responding to the findings report by one month (i.e., to 30 September), as substantial work may be required to explain or rectify any perceived issues resulting from the initial findings.</p> | <p>objectives and that a holistic approach needs to be taken in assessing the methodology but any conclusion would take into account the performance against each principle, and how competing objectives have been reconciled.</p> <p>Noted. The Commission will revise the proposed approach in relation to the objectives of the first review</p> <p>Noted.</p> <p>Agrees that the response should be extended by one month to 30 September.</p> <p>The first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>Would expect that this in turn would push out publishing of the summary report to 31 October.</p> <p>Support the proposal that individual distributors reviews will only take place when a distributor amends its pricing methodology report (and not for annual price changes), but it is unclear how regularly the summary report will be released after the first year (i.e., annually or only when a certain number of distributors change their methodologies). Preference would be for the review to occur either, the sooner of every three years or after more than a quarter of the distributors have changed their pricing methodologies.</p> <p>The Commission also proposes that subsequent reviews should also take place when a distributor has not amended a materially non-compliant methodology. Submitter queries the value of reports on <i>unchanged</i> non-compliant pricing methodologies. Clearly it would be important to put pressure on those companies with non-compliant methodologies to improve, but it is not necessary to undertake review of pricing methodologies that have not changed. Accordingly, submits that reviews should only take place where pricing methodologies change.</p> | <p>Noted.</p> <p>Agree that that reviews should only take place where pricing methodologies change.</p> |
| Unison | Partial | <p>Support the Commission's proposal of periodic independent expert reviews to measure an EDB's compliance with the pricing principles, using the information disclosure guidelines.</p> <p>Reiterates previous comments in respect to the publication of the results of the independent expert's review; that the report should focus on the quality of the decision making, as each EDB is different due to a number of factors, like size, geographical location, ownership and age.</p> <p>In respect to the reporting requirements proposed for the 2010 year, see no benefit in an independent review being conducted, or for EDBs to respond to such a review by the 31 August 2010. The reason for this view is that EDBs are likely to have published new prices, and associated pricing methodologies before the pricing principles are published</p> | <p>Noted.</p> <p>Noted.</p> <p>Noted. The Commission will revise the proposed approach in relation to the</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>in February 2010. It would be more appropriate for a review to be conducted in the following year, once new prices and methodologies are designed on the finalised principles. We then consider that the second independent review should happen in 2013, so EDBs have time to respond to the findings in the 2011 review, and have the ability to take into account any price adjustments in 2012.</p> | <p>objectives of the first review.</p> <p>The first formal review against the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |
| <p>Powerco</p> | | <p>Concerned about the feasibility of the timeline. Table One²⁹ highlights a number of issues. It compares Powerco's timeline for annual price changes, the Commission's proposal, the Commerce Commission's electricity information disclosure and default price path (DPP) work.</p> <p><i>a) Less than 2 months to produce 2010 pricing methodology</i></p> <p>The Commission plans to publish the final pricing principles in February 2010. Powerco's prices (and methodology are) are finalised at the end of December 2009 (i.e. we have just finalised the prices for 1 April 2010) and released to retailers at the end of January 2010. The 2010 methodology and prices have been developed without consideration of the Commission's principles and will contain no changes as a reaction to the pricing principles. This timeline provides less than two months for Powerco to consider the principles and prepare our disclosure. This is insufficient time.</p> <p><i>b) Less than 2 months to consider changes suggested by the independent reviewer</i></p> <p>Powerco aims to begin consultation with retailers six to seven months (i.e. October 2010 for implementation from April 2011) before price changes take effect. If the independent review's findings are published at the end of July, Powerco has less than 2 months to consider the review's recommendations and develop price changes in</p> | <p>Noted. The Commission will revise the proposed approach in relation to the objectives of the first review</p> <p>Agree. The first formal review against</p> |

²⁹ See Appendix 2

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| | | <p>response. The Commission has proposed that EDBs respond to the findings of the independent review by 31 August 2010. This increases the workload of EDBs at this time and further reduces the capacity to take into account the recommendations. The new Commerce Commission information disclosure requirements are unlikely to be published before the input methodologies are finalised in December 2010. The Commerce Commission has not published the date for finalising the new electricity information disclosure requirements, so Powerco is uncertain when the new pricing methodology requirements will apply from.</p> <p>Also note that the Electricity Industry Bill will remove the requirement for the Commerce Commission to develop a pricing methodology input methodology if the Electricity Authority develops its own regulations.² The Bill does not change the Commerce Commission's information disclosure scope, so Powerco assumes pricing methodologies will continue to be disclosed to the Commerce Commission.</p> <p>It is clear that the information disclosure requirements will need to be shaped by the input methodology determinations. As these are unlikely to be finalised before 31 December 2010, the pricing methodologies will probably still need to use the current Commerce Commission requirements. This may mean that the second independent review (and final review if no significant changes are suggested by distributors) may not include the Commission's proposed information disclosure guidelines.</p> <p>Recommends that the first independent review takes place in April 2011. Reviewing the 2010 methodology is a waste of resource as EDBs will have had around a month to explain how the methodology meets the principles and the methodology will contain no changes by EDBs in response to the principles.</p> <p>Powerco has been a supporter of a voluntary principles - based approach and agrees with the Commission when it states that, "this is an opportunity for distributors to show that a light-handed approach will result in improvements". Unfair judgements will be formed about the effort distributors have made to comply with the principles.</p> | <p>the principles will be based on the disclosures for the April 2011 to March 2012 period.</p> |

| Submitter | Agree/ disagree | Response to question | Commission Comments |
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| | | <p>The Gas Authorisation process published pricing principles on 30 October 2008, then provided 7 months to develop the methodology and prices (by 1 May 2009). Powerco then made price changes 5 months later on 1 October 2009. Our experience was that this timeline was tight, and a first disclosure of April 2011 is more feasible.</p> <p>Also note that the Electricity Industry Bill includes a provision for the Minister of Energy and Resources to make rules on electricity line tariff structure around October 2011 (12 months after the Electricity Market Authority (EMA) is established, which is proposed to be October 2010). This fits well with a first disclosure to pricing methodologies following the EC guidelines on 1 April 2011.</p> <p>Supports the Commission's proposal that only two reviews are initially required, and that further reviews should be conducted only where there are significant changes to the methodology. Predict that the earliest opportunity to complete a review using the Commission's proposed guidelines will be April – July 2012. If the first review takes place in April-July 2011, it follows that the second review should take place in April-July 2013.</p> | |

